Republic of the Philippines
SUPREME COURT
Baguio City

FIRST DIVISION

G.R. No. 113412 April 17, 1996

Spouses PONCIANO ALMEDA and EUFEMIA P. ALMEDA, petitioner,
vs.
THE COURT OF APPEALS and PHILIPPINE NATIONAL BANK, respondents.

KAPUNAN, ***J.:*** *p*

On various dates in 1981, the Philippine National Bank granted to herein petitioners, the spouses Ponciano L. Almeda and Eufemia P. Almeda several loan/credit accommodations totaling P18.0 Million pesos payable in a period of six years at an interest rate of 21% *per annum*. To secure the loan, the spouses Almeda executed a Real Estate Mortgage Contract covering a 3,500 square meter parcel of land, together with the building erected thereon (the Marvin Plaza) located at Pasong Tamo, Makati, Metro Manila. A credit agreement embodying the terms and conditions of the loan was executed between the parties. Pertinent portions of the said agreement are quoted below:

> *SPECIAL CONDITIONS*
>
> xxx xxx xxx
>
> The loan shall be subject to interest at the rate of twenty one per cent (21%) *per annum*, payable semi-annually in arrears, the first interest payment to become due and payable six (6) months from date of initial release of the loan. The loan shall likewise be subject to the appropriate service charge and a penalty charge of three per cent (30%) *per annum* to be imposed on any amount remaining unpaid or not rendered when due.
>
> xxx xxx xxx
>
> III. OTHER CONDITIONS
>
> (c) Interest and Charges
>
>> (1) The Bank reserves the right to increase the interest rate *within the limits allowed by law* at any time depending on whatever policy it may adopt in the future; provided, that the interest rate on this/these accommodations shall be correspondingly decreased in the event that the applicable maximum interest rate is reduced by law or by the Monetary Board. In either case, the adjustment in the *interest rate* agreed upon shall take effect on the effectivity date of the increase or decrease of the maximum interest rate. [1]

Between 1981 and 1984, petitioners made several partial payments on the loan totaling. P7,735,004.66, [2] a substantial portion of which was applied to accrued interest. [3] On March 31, 1984, respondent bank, over petitioners' protestations, raised the interest rate to 28%, allegedly pursuant to Section III-c (1) of its credit agreement. Said interest rate thereupon increased from an initial 21% to a high of 68% between March of 1984 to September, 1986. [4]

Petitioner protested the increase in interest rates, to no avail. Before the loan was to mature in March, 1988, the spouses filed on February 6, 1988 a petition for declaratory relief with prayer for a writ of preliminary injunction and temporary restraining order with the Regional Trial Court of Makati, docketed as Civil Case No. 18872. In said petition, which was raffled to Branch 134 presided by Judge Ignacio Capulong, the spouses sought clarification as

to whether or not the PNB could unilaterally raise interest rates on the loan, pursuant to the credit agreement's escalation clause, and in relation to Central Bank Circular No. 905. As a preliminary measure, the lower court, on March 3, 1988, issued a writ of preliminary injunction enjoining the Philippine National Bank from enforcing an interest rate above the 21% stipulated in the credit agreement. By this time the spouses were already in default of their loan obligations.

Invoking the Law on Mandatory Foreclosure (Act 3135, as amended and P.D. 385), the PNB countered by ordering the extrajudicial foreclosure of petitioner's mortgaged properties and scheduled an auction sale for March 14, 1989. Upon motion by petitioners, however, the lower court, on April 5, 1989, granted a supplemental writ of preliminary injunction, staying the public auction of the mortgaged property.

On January 15, 1990, upon the posting of a counterbond by the PNB, the trial court dissolved the supplemental writ of preliminary injunction. Petitioners filed a motion for reconsideration. In the interim, respondent bank once more set a new date for the foreclosure sale of Marvin Plaza which was March 12, 1990. Prior to the scheduled date, however, petitioners tendered to respondent bank the amount of P40,142,518.00, consisting of the principal (P18,000,000.00) and accrued interest calculated at the originally stipulated rate of 21%. The PNB refused to accept the payment. [5]

As a result of PNB's refusal of the tender of payment, petitioners, on March 8, 1990, formally consigned the amount of P40,142,518.00 with the Regional Trial Court in Civil Case No. 90-663. They prayed therein for a writ of preliminary injunction with a temporary restraining order. The case was raffled to Branch 147, presided by Judge Teofilo Guadiz. On March 15, 1990, respondent bank sought the dismissal of the case.

On March 30, 1990 Judge Guadiz in Civil Case No. 90-663 issued an order granting the writ of preliminary injunction enjoining the foreclosure sale of "Marvin Plaza" scheduled on March 12, 1990. On April 17, 1990 respondent bank filed a motion for reconsideration of the said order.

On August 16, 1991, Civil Case No. 90-663 we transferred to Branch 66 presided by Judge Eriberto Rosario who issued an order consolidating said case with Civil Case 18871 presided by Judge Ignacio Capulong.

For Judge Ignacio's refusal to lift the writ of preliminary injunction issued March 30, 1990, respondent bank filed a petition for *Certiorari*, Prohibition and *Mandamus* with respondent Court of Appeals, assailing the following orders of the Regional Trial Court:

> 1. Order dated March 30, 1990 of Judge Guadiz granting the writ of preliminary injunction restraining the foreclosure sale of Mavin Plaza set on March 12, 1990;
>
> 2. Order of Judge Ignacio Capulong dated January 10, 1992 denying respondent bank's motion to lift the writ of injunction issued by Judge Guadiz as well as its motion to dismiss Civil Case No. 90-663;
>
> 3. Order of Judge Capulong dated July 3, 1992 denying respondent bank's subsequent motion to lift the writ of preliminary injunction; and
>
> 4. Order of Judge Capulong dated October 20, 1992 denying respondent bank's motion for reconsideration.

On August 27, 1993, respondent court rendered its decision setting aside the assailed orders and upholding respondent bank's right to foreclose the mortgaged property pursuant to Act 3135, as amended and P.D. 385. Petitioners' Motion for Reconsideration and Supplemental Motion for Reconsideration, dated September 15, 1993 and October 28, 1993, respectively, were denied by respondent court in its resolution dated January 10, 1994.

Hence the instant petition.

This appeal by *certiorari* from the respondent court's decision dated August 27, 1993 raises two principal issues namely: 1) Whether or not respondent bank was authorized to raise its interest rates from 21% to as high as 68% under the credit agreement; and 2) Whether or not respondent bank is granted the authority to foreclose the Marvin Plaza under the mandatory foreclosure provisions of P.D. 385.

In its comment dated April 19, 1994, respondent bank vigorously denied that the increases in the interest rates were illegal, unilateral, excessive and arbitrary, it argues that the escalated rates of interest it imposed was based on the agreement of the parties. Respondent bank further contends that it had a right to foreclose the mortgaged property pursuant to P.D. 385, after petitioners were unable to pay their loan obligations to the bank based on the increased rates upon maturity in 1984.

The instant petition is impressed with merit.

The binding effect of any agreement between parties to a contract is premised on two settled principles: (1) that any obligation arising from contract has the force of law between the parties; and (2) that there must be mutuality

between the parties based on their essential equality. [6] Any contract which appears to be heavily weighed in favor of one of the parties so as to lead to an unconscionable result is void. Any stipulation regarding the validity or compliance of the contract which is left solely to the will of one of the parties, is likewise, invalid.

It is plainly obvious, therefore, from the undisputed facts of the case that respondent bank unilaterally altered the terms of its contract with petitioners by increasing the interest rates on the loan without the prior assent of the latter. In fact, the manner of agreement is itself explicitly stipulated by the Civil Code when it provides, in Article 1956 that "No interest shall be due unless it has been expressly stipulated in writing." What has been "stipulated in writing" from a perusal of interest rate provision of the credit agreement signed between the parties is that petitioners were bound merely to pay 21% interest, subject to a possible escalation or de-escalation, when 1) the circumstances warrant such escalation or de-escalation; 2) within the limits allowed by law; and 3) upon agreement.

Indeed, the interest rate which appears to have been agreed upon by the parties to the contract in this case was the 21% rate stipulated in the interest provision. Any doubt about this is in fact readily resolved by a careful reading of the credit agreement because the same plainly uses the phrase "interest rate *agreed upon*," in reference to the original 21% interest rate. The interest provision states:

> (c) interest and Charges
>
> (1) The Bank reserves the right to increase the interest rate *within the limits allowed by law* at any time depending on whatever policy it may adopt in the future; provided, that the interest rate on this/these accommodations shall be correspondingly decreased in the event that the applicable maximum interest rate is reduced by law or by the Monetary Board. In either case, the adjustment in the *interest rate agreed upon* shall take effect on the effectivity date of the increase or decrease of the maximum interest rate.

In *Philippine National Bank v. Court of Appeals*, [7] this Court disauthorized respondent bank from unilaterally raising the interest rate in the borrower's loan from 18% to 32%, 41% and 48% partly because the aforestated increases violated the principle of mutuality of contracts expressed in Article 1308 of the Civil Code. The Court held:

> > CB Circular No. 905, Series of 1982 (Exh. 11) removed the Usury Law ceiling on interest rates —
> >
> > . . . increases in interest rates are not subject to any ceiling prescribed by the Usury Law.
>
> but it did not authorize the PNB, or any bank for that matter, to unilaterally and successively increase the agreed interest rates from 18% to 48% within a span of four (4) months, in violation of P.D. 116 which limits such changes to once every twelve months.
>
> Besides violating P.D. 116, the unilateral action of the PNB in increasing the interest rate on the private respondent's loan, violated the mutuality of contracts ordained in Article 1308 of the Civil Code:
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> Art. 308. The contract must bind both contracting parties; its validity or compliance cannot be left to the will of one of them.
>
> In order that obligations arising from contracts may have the force of law between the parties, there must be *mutuality* between the parties based on their essential equality. A contract containing a condition which makes its fulfillment dependent exclusively upon the uncontrolled will of one of the contracting parties, is void (Garcia vs. Rita Legarda, Inc., 21 SCRA 555). Hence, even assuming that the P1.8 million loan agreement between the PNB and the private respondent gave the PNB a license (although in fact there was none) to increase the interest rate at will during the term of the loan, that license would have been null and void for being violative of the principle of mutuality essential in contracts. It would have invested the loan agreement with the character of a contract of adhesion, where the parties do not bargain on equal footing, the weaker party's (the debtor) participation being reduced to the alternative "to take it or lease it" (Qua vs. Law Union & Rock Insurance Co., 95 Phil. 85). Such a contract is a veritable trap for the weaker party whom the courts of justice must protect against abuse and imposition.
>
> PNB's successive increases of the interest rate on the private respondent's loan, over the latter's protest, were arbitrary as they violated an express provision of the Credit Agreement (Exh. 1) Section 9.01 that its terms "may be amended only by an instrument in writing signed by the party to be bound as burdened by such amendment." The increases imposed by PNB also contravene Art. 1956 of the Civil Code which provides that "no interest shall be due unless it has been expressly stipulated in writing."

> The debtor herein never agreed in writing to pay the interest increases fixed by the PNB beyond 24% *per annum*, hence, he is not bound to pay a higher rate than that.
>
> That an increase in the interest rate from 18% to 48% within a period of four (4) months is excessive, as found by the Court of Appeals, is indisputable.

Clearly, the galloping increases in interest rate imposed by respondent bank on petitioners' loan, over the latter's vehement protests, were arbitrary.

Moreover, respondent bank's reliance on C.B. Circular No. 905, Series of 1982 did not authorize the bank, or any lending institution for that matter, to progressively increase interest rates on borrowings to an extent which would have made it virtually impossible for debtors to comply with their own obligations. True, escalation clauses in credit agreements are perfectly valid and do not contravene public policy. Such clauses, however, (as are stipulations in other contracts) are nonetheless still subject to laws and provisions governing agreements between parties, which agreements — while they may be the law between the contracting parties — implicitly incorporate provisions of existing law. Consequently, while the Usury Law ceiling on interest rates was lifted by C.B. Circular 905, nothing in the said circular could possibly be read as granting respondent bank *carte blanche* authority to raise interest rates to levels which would either enslave its borrowers or lead to a hemorrhaging of their assets. Borrowing represents a transfusion of capital from lending institutions to industries and businesses in order to stimulate growth. This would not, obviously, be the effect of PNB's unilateral and lopsided policy regarding the interest rates of petitioners' borrowings in the instant case.

Apart from violating the principle of mutuality of contracts, there is authority for disallowing the interest rates imposed by respondent bank, for the credit agreement specifically requires that the increase be "within the limits allowed by law". In the case of *PNB v. Court of Appeals*, cited above, this Court clearly emphasized that C.B. Circular No. 905 could not be properly invoked to justify the escalation clauses of such contracts, not being a grant of specific authority.

Furthermore, the escalation clause of the credit agreement requires that the same be made "within the limits allowed by law," obviously referring specifically to legislative enactments not administrative circulars. Note that the phrase "limits imposed by law," refers only to the escalation clause. However, the same agreement allows reduction on the basis of law or the Monetary Board. Had the parties intended the word "law" to refer to both legislative enactments and administrative circulars and issuances, the agreement would not have gone as far as making a distinction between "law or the Monetary Board Circulars" in referring to mutually agreed upon reductions in interest rates. This distinction was the subject of the Court's disquisition in the case of *Banco Filipino Savings and Mortgage Bank v. Navarro* [8] where the Court held that:

> What should be resolved is whether BANCO FILIPINO can increase the interest rate on the LOAN from 12% to 17% *per annum* under the Escalation Clause. It is our considered opinion that it may not.
>
> The Escalation Clause reads as follows:
>
> I/We hereby authorize Banco Filipino to *correspondingly increase*.
>
> the interest rate stipulated in this contract without advance notice to me/us in the event.
>
> a law
>
> increasing
>
> the lawful rates of interest that may be charged
>
> *on this particular*
>
> *kind of loan*. (Paragraphing and emphasis supplied)
>
> It is clear from the stipulation between the parties that the interest rate may be increased "in the event a *law* should be enacted increasing the lawful rate of interest that may be charged *on this particular kind of loan*." The Escalation Clause was dependent on an increase of rate made by "law" alone.
>
> CIRCULAR No. 494, although it has the effect of law, is not a law. "Although a circular duly issued *is not strictly a statute or a law*, it has, however, the force and effect of law." (Emphasis supplied). "An administrative regulation adopted pursuant to law has the force and effect of law." "That administrative rules and regulations have the force of law can no longer be questioned."

> The distinction between a law and an administrative regulation is recognized in the Monetary Board guidelines quoted in the latter to the BORROWER of Ms. Paderes of September 24, 1976 (*supra*). According to the guidelines, for a loan's interest to be subject to the increases provided in CIRCULAR No. 494, there must be an Escalation Clause allowing the increase "in the event that *any law or Central Bank regulation* is promulgated increasing the maximum rate for loans." The guidelines thus presuppose that a Central Bank regulation is not within the term "any law."
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> The distinction is again recognized by P.D. No. 1684, promulgated on March 17, 1980, adding section 7-a to the Usury Law, providing that parties to an agreement pertaining to a loan could stipulate that the rate of interest agreed upon may be increased in the event that the applicable maximum rate of interest is increased "*by law or by the Monetary Board*." To quote:
>
>> Sec. 7-a. Parties to an agreement pertaining to a loan or forbearance of money, goods or credits may stipulate that the rate of interest agreed upon may be increased in the event that the applicable maximum rate of interest
>>
>> is increased by law or by the Monetary Board:
>>
>> *Provided*, That such stipulation shall be valid only if there is also a stipulation in the agreement that the rate of interest agreed upon shall be reduced in the event that the applicable maximum rate of interest is reduced by law or by the Monetary Board;
>>
>> *Provided, further*, That the adjustment in the rate of interest agreed upon shall take effect on or after the effectivity of the increase or decrease in the maximum rate of interest.' (Paragraphing and emphasis supplied).
>
> It is now clear that from March 17, 1980, escalation clauses to be valid should specifically provide: (1) that there can be an increase in interest if increased by law or by the Monetary Board; and (2) in order for such stipulation to be valid, it must include a provision for reduction of the stipulated interest "in the event that the applicable maximum rate of interest is reduced by law or by the Monetary Board."

Petitioners never agreed in writing to pay the increased interest rates demanded by respondent bank in contravention to the tenor of their credit agreement. That an increase in interest rates from 18% to as much as 68% is excessive and unconscionable is indisputable. Between 1981 and 1984, petitioners had paid an amount equivalent to virtually half of the entire principal (P7,735,004.66) *which was applied to interest alone*. By the time the spouses tendered the amount of P40,142,518.00 in settlement of their obligations; respondent bank was demanding P58,377,487.00 over and above those amounts already previously paid by the spouses.

Escalation clauses are not basically wrong or legally objectionable so long as they are not solely potestative but based on reasonable and valid grounds. [9] Here, as clearly demonstrated above, not only the increases of the interest rates on the basis of the escalation clause patently unreasonable and unconscionable, but also there are no valid and reasonable standards upon which the increases are anchored.

We go now to respondent bank's claim that the principal issue in the case at bench involves its right to foreclose petitioners' properties under P.D. 385. We find respondent's pretense untenable.

Presidential Decree No. 385 was issued principally to guarantee that government financial institutions would not be denied substantial cash inflows necessary to finance the government's development projects all over the country by large borrowers who resort to litigation to prevent or delay the government's collection of their debts or loans. [10] In facilitating collection of debts through its automatic foreclosure provisions, the government is however, not exempted from observing basic principles of law, and ordinary fairness and decency under the due process clause of the Constitution. [11]

In the first place, because of the dispute regarding the interest rate increases, an issue which was never settled on merit in the courts below, the exact amount of petitioner's obligations could not be determined. Thus, the foreclosure provisions of P.D. 385 could be validly invoked by respondent only after settlement of the question involving the interest rate on the loan, and only after the spouses refused to meet their obligations following such determination. In *Filipinas Marble Corporation v. Intermediate Appellate Court*, [12] involving P.D. 385's provisions on mandatory foreclosure, we held that:

> We cannot, at this point, conclude that respondent DBP together with the Bancom people actually misappropriated and misspent the $5 million loan in whole or in part although the trial court found that there is "persuasive" evidence that such acts were committed by the respondent. This matter should rightfully be litigated below in the main action. Pending the outcome of such litigation, P.D. 385 cannot automatically be applied for if it is really proven that respondent DBP is responsible for the misappropriation of the loan, even if only in part, then the foreclosure of the petitioner's properties

> under the provisions of P.D. 385 to satisfy the whole amount of the loan would be a gross mistake. It would unduly prejudice the petitioner, its employees and their families.
>
> Only after trial on the merits of the main case can the true amount of the loan which was applied wisely or not, for the benefit of the petitioner be determined. Consequently, the extent of the loan where there was no failure of consideration and which may be properly satisfied by foreclosure proceedings under P.D. 385 will have to await the presentation of evidence in a trial on the merits.

In *Republic Planters Bank v. Court of Appeals* [13] the Court reiterating the *dictum* in Filipinas Marble Corporation, held:

> The enforcement of P.D. 385 will sweep under the rug' this iceberg of a scandal in the sugar industry during the Marcos Martial Law years. This we can not allow to happen. For the benefit of future generations, all the dirty linen in the PHILSUCUCOM/NASUTRA/RPB closets have to be exposed in public so that the same may NEVER be repeated.
>
> It is of paramount national interest, that we allow the trial court to proceed with dispatch to allow the parties below to present their evidence.

Furthermore, petitioners made a valid consignation of what they, in good faith and in compliance with the letter of the Credit Agreement, honestly believed to be the real amount of their remaining obligations with the respondent bank. The latter could not therefore claim that there was no honest-to-goodness attempt on the part of the spouse to settle their obligations. Respondent's rush to inequitably invoke the foreclosure provisions of P.D. 385 through its legal machinations in the courts below, in spite of the unsettled differences in interpretation of the credit agreement was obviously made in bad faith, to gain the upper hand over petitioners.

In the face of the unequivocal interest rate provisions in the credit agreement and in the law requiring the parties to agree to changes in the interest rate in writing, we hold that the unilateral and progressive increases imposed by respondent PNB were null and void. Their effect was to increase the total obligation on an eighteen million peso loan to an amount way over three times that which was originally granted to the borrowers. That these increases, occasioned by crafty manipulations in the interest rates is unconscionable and neutralizes the salutary policies of extending loans to spur business cannot be disputed.

WHEREFORE, PREMISES CONSIDERED, the decision of the Court of Appeals dated August 27, 1993, as well as the resolution dated February 10, 1994 is hereby REVERSED AND SET ASIDE. The case is remanded to the Regional Trial Court of Makati for further proceedings.

SO ORDERED.

Bellosillo and Hermosisima, Jr., JJ., concur.

Padilla and Vitug, JJ., took no part.

Footnotes

1 *Rollo*, pp. 48-55.

2 *Id*., at ,165.

3 *Id*.

4 *Id*.

5 The PNB claimed that as of March 12, 1990, the spouses balance was P58,377,487.31, using the increased interest rates for computing accrued interest.

6 Garcia v. Legarda, 21 SCRA 555 (1967).

7 196 SCRA 536, 543 (1991).

8 152 SCRA 346 (1987).

9 Vitug's Compedium of Civil Law and Jurisprudence, Revised Edition, 1993, p. 533, *citing* PNB v. IAC, 183 SCRA 133; PNB v. Court of Appeals, 196, SCRA 536.

10 Sections 1 and 2 of P.D. 385 provide:

> Sec. 1. It shall be mandatory for government financial institutions, after the lapse of sixty (60) days from the issuance of this Decree, to foreclose the collaterals and/or securities for any loan, credit

accommodation, and/or guarantees granted by them whenever the arrearages on such account, concluding accrued interest and other obligations, including interest and other charges, as appearing in the book of accounts and/or related records of the financial institution concerned. This shall be without prejudice to the exercise by the government financial institution of such rights and/or remedies available to them under their respective contracts with their debtors, including the right to foreclose on loans, credits, accommodations, and/or guarantees on which the arrearages are less than twenty percent (20%).

Sec. 2. No restraining order, temporary or permanent injunction shall be issued by the court against any government financial institution in any action taken by such institution in compliance with the mandatory foreclosure provided in Section 1 hereof, whether such restraining order, temporary or permanent injunction is sought by the borrower(s) or any third party or parties, except after due hearing in which it is established by the borrower,

and admitted by the government financial institution concerned that twenty percent (20%) of the outstanding arrearages has been paid after the filing of foreclosure proceedings.

11 Filipinas Marble Corporation v. Intermediate Appellate Court, 142 SCRA 181 (1986).

12 *Id*.

13 213 SCRA 413 (1992).